Box 4.3

## DEVELOPMENTS IN BANK FINANCE FOR PRODUCTIVE ACTIVITIES IN THE CONTEXT OF THE COVID-19 CRISIS

The liquidity needs of Spanish non-financial corporations (hereinafter NFCs) have grown significantly since the outbreak of the health crisis, owing to income from ordinary activities declining sharply for most firms as activity ground to a halt during the state of alert and demand fell. Many of these firms have resorted to bank finance to cover their liquidity needs, in some cases benefiting from the State guarantees approved by Royal Decree-Law 8/2020 of 17 March 2020, via the COVID-19 ICO Guarantee Facility (hereinafter, ICO facility). The facility will guarantee up to a maximum of €100 billion, covering up to 80% of the potential losses on finance extended to the self-employed and SMEs, and up to 70% or 60% of financing extended to firms that do not satisfy the European Commission's definition of a SME (hereinafter, large enterprises), depending on whether they are new loans or rollovers.

This Box describes the developments in new loans extended to finance productive activities during March and April 2020, distinguishing between loans implemented through the ICO facility and other lending. It further analyses the extent to which the funds obtained by NFCs through these transactions have helped to address their liquidity needs. Also examined are the terms and conditions of the loans extended under the ICO facility.

Chart 1 shows data for new credit drawn and undrawn to finance productive activities during March and April 2020, both with and without State guarantees.[1] The first two tranches of the guarantee programme, amounting to €40 billion – of which €30 billion was earmarked for SMEs and the self-employed, and the rest for large enterprises – were approved during this period and a total of nearly €26.5 billion was disbursed. For the purposes of comparing new lending in the most recent period against the pre-crisis situation, the amount of new loans arranged during the same period in 2019 is also presented. The chart shows that lending to finance productive activities, extended mainly to NFCs, grew significantly in March and April 2020 as compared with the previous year, reaching €98.3 billion. Although the amount of bank finance not guaranteed by the ICO facility (€63.8 billion) amply exceeded total new lending in March and April 2019 (€48.3 billion), the bulk of the increase was attributable to the sizeable borrowing under the ICO facility (€34.6 billion).

Credit guaranteed by the ICO facility centred on the SME segment (€22.9 billion), while most of the bank finance extended to large enterprises was not guaranteed by the facility (€39 billion out of a total of €48.5 billion). Also noteworthy is the €9.1 billion increase in finance available to large enterprises through credit lines that do not benefit from the State guarantee. The bulk of this credit was extended in April, as large corporations to a significant extent resorted to their existing lines of credit at the onset of the health crisis. In finance provided to the self-employed, the ICO facility made a notably large contribution (€2.2 billion) to the overall credit obtained in March and April 2020 (€4 billion), slightly up on the financing obtained in the same period of the previous year.

Chart 2 illustrates how the new credit was distributed based on the NFCs' estimated liquidity needs. These have been calculated using company information in the Integrated Central Balance Sheet Data Office Survey (CBI)[2] and include both potential deficits (payments minus receipts) from the firms' ordinary activities this year and the outlays associated with debt repayments between March and December 2020.[3] The first bar in Chart 2 shows that 92% of the new bank credit originated in March and April 2020 was provided to firms with liquidity needs. These firms represent 67% of Spanish NFCs and employ 73% of the workers in the sector. The subsequent bars in Chart 2 refer to these firms and depict the distribution of the two credit types (ICO facility and other) in different categories of firms. Around 35% of the finance received by the NFCs needing liquidity was

1 The data for the ICO facility are provided by the ICO itself, while the figures for other lending are obtained from the Banco de España Central Credit Register (CCR).

2 The CBI includes information on some 500,000 non-financial corporations and represents, in GVA terms, around 42% of the overall NFC sector (according to National Accounts). Given that these firms represent a sub-sample of the universe of companies in the Spanish economy, the results are adjusted using weights to estimate a representative figure for the overall NFC sector.

3 The needs stemming from the firms' ordinary activities are obtained through a simulation, which assumes a severe contraction of their activity in 2020 as compared with 2018 (the latest available CBI data), distinguishing between sectors based on the extent to which they are affected by the pandemic. The outlays associated with debt repayments are estimated based on data from the CCR and the firms' balance sheet information. It should be borne in mind that the firms' liquidity needs may include measurement errors since they are identified through simulation. For further details, see R. Blanco, A. Menéndez and M. Mulino (2020): *Las necesidades de liquidez y la solvencia de las empresas no financieras españolas tras la perturbación del Covid-19*, Occasional Papers, Banco de España, forthcoming.

accounted for by the ICO facility loans. However, this proportion is not consistent across all of the different company types. As might be expected, the ICO's weight is comparatively greater in the segments with the worst conditions of access to credit: SMEs (57%), firms operating in the sectors most affected by the health crisis (47%) and riskier firms (56%).[4] Conversely, the ICO guarantee facility was used to a lesser extent in lending to large enterprises

Chart 1
NEW CREDIT TRANSACTIONS TO FINANCE PRODUCTIVE ACTIVITIES (a)

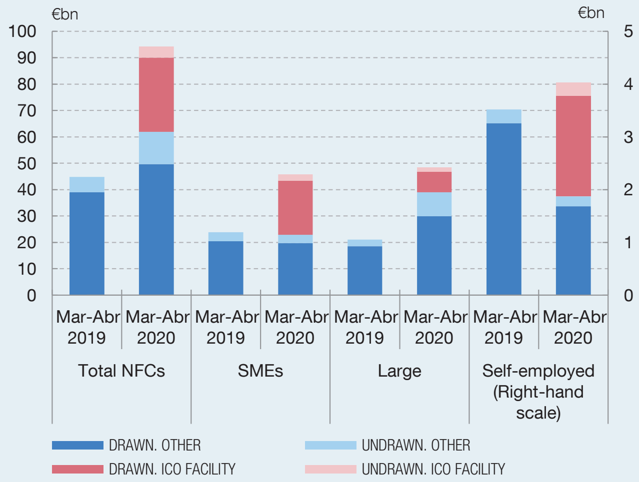



Chart 2
DISTRIBUTION OF NEW CREDIT TRANSACTIONS BY NFCs' LIQUIDITY NEEDS. MARCH-APRIL 2020 (a) (b)

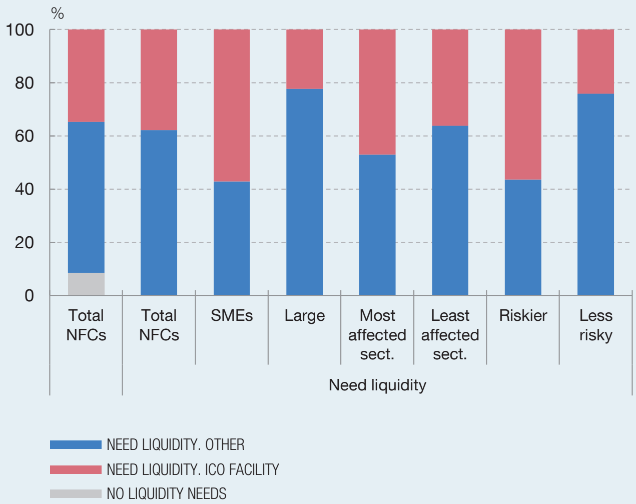



Chart 3
COVERAGE OF LIQUIDITY NEEDS BY NFCs' SIZE AND RISK. MARCH-APRIL 2020 (a) (b)

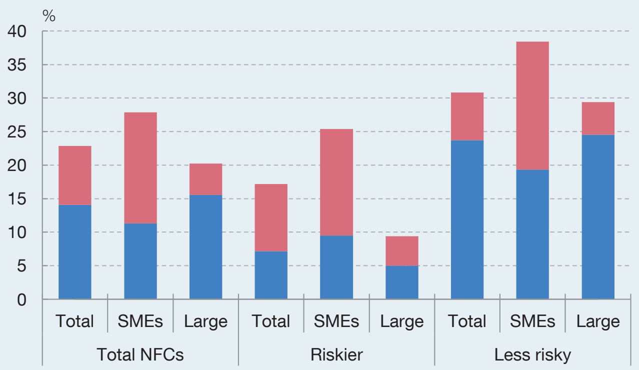
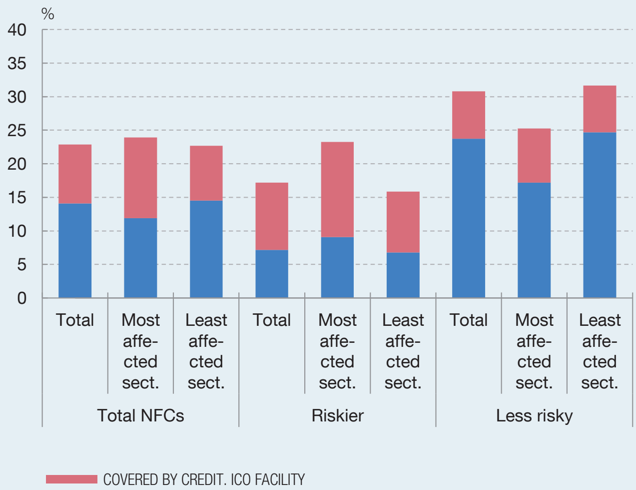



Chart 4
COVERAGE OF LIQUIDITY NEEDS BY NFCs' SECTOR AND RISK. MARCH-APRIL 2020 (a) (b)




**SOURCE:** Banco de España.

a Includes credit drawn and undrawn. The firms are classified based on their size, risk and sector. Size is defined in line with the European Commission Recommendation. Small firms forming part of a business group are not classified as SMEs. Riskier firms are those with credit quality steps (CQS) of 6, 7 or 8, meaning a probability of default of over 2%. Lastly, the sectors most affected by the health crisis are transport, hospitality, catering, entertainment and motor vehicles.

b The firms' liquidity needs are identified based on a simulation of their ordinary activities during 2020 and debt repayments between March and December 2020.

4 The sectors most affected by the health crisis are: transport, hospitality, catering, entertainment and motor vehicles. Riskier companies are those with a credit quality step (CQS) of 6, 7 or 8, meaning a probability of default of over 2%.

and less risky firms, where its weight stood at 22% and 24%, respectively.

Chart 3 shows that, on average, new credit covered around 23% of the firms' estimated liquidity needs between March and December 2020. Further, the chart demonstrates that loans arranged through the ICO facility played a particularly important role in addressing the liquidity needs of SMEs, covering close to 17% (compared with around 11% covered by credit not linked to the facility). Whereas loans extended to large enterprises under the guarantee programme covered just 5% of their liquidity needs, while other credit accounted for more than 16%.

Admittedly, the ICO facility has helped significantly to address the liquidity needs of riskier firms. But to date these companies have not been able to cover their needs to the same extent as less risky companies, particularly in the case of large enterprises, which may reflect greater restrictions in terms of their access to bank finance.

Chart 4 shows that the credit needs of NFCs operating in the sectors most affected by the health crisis and with a higher probability of default on their debts have been considerably alleviated by the credit originated under the guarantee programme.

Finally, Charts 5, 6 and 7 show the terms and conditions (interest rates, maturities and amounts) of the loans extended through the guarantee programme as compared with the terms and conditions of other bank finance before and during the pandemic. Chart 5 shows that the average interest rate of loans under the guarantee programme stood at 2.1% in the SME segment and 2.2% for large enterprises. These are significantly lower than the interest rates on loans not linked to the ICO facility and arranged during the same period or in the weeks prior to the state of alert, which range from 2.6% to 2.8%.[5] Likewise, the ICO facility credit has considerably longer maturities in both company segments, exceeding the maturities of other loans extended before and during the pandemic by more than three years (see Chart 6). Lastly, the loan amounts under the guarantee programme are likewise clearly larger than those of the other loans (see Chart 7). Given that the borrowers in transactions benefiting from State guarantees may not be exactly comparable with the borrowers in the other two types of credit, a regression analysis has been conducted comparing the terms and conditions of the loans guaranteed by the programme against the loans with no guarantee that are extended by the same bank and to the same company, while controlling for other characteristics of the loans. The results confirm the differences described above.

Chart 5
NEW CREDIT TRANSACTION INTEREST RATES (c)

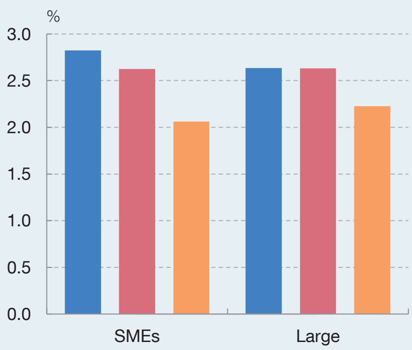
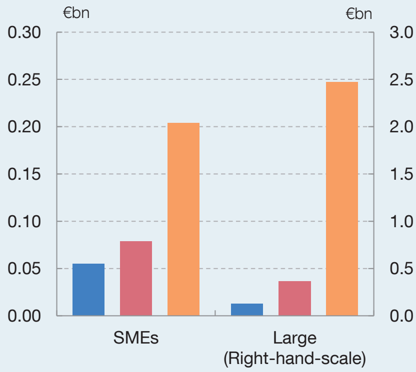



Chart 6
NEW CREDIT TRANSACTION MATURITIES (c)


Chart 7
NEW CREDIT TRANSACTION AMOUNTS (c)




TOTAL (1 FEB-17 MAR) NON-ICO (18 MAR-30 APR) ICO (18 MAR-30 APR)

**SOURCE:** Banco de España.

c ICO indicates credit implemented through the ICO facility and non-ICO indicates all other credit transactions. The credit includes the amount drawn and undrawn. Excluded are transactions with maturities of less than one month. Size (SME and large) is defined in line with the European Commission Recommendation. In accordance with the European Commission, small firms forming part of a business group are not classified as SMEs.

5 Although these interest rates do not include fees, the differences are likely to be almost the same given that the average front-end fee for ICO facility transactions stands at 0.2%.

Box 4.3

**DEVELOPMENTS IN BANK FINANCE FOR PRODUCTIVE ACTIVITIES IN THE CONTEXT OF THE COVID-19 CRISIS** (cont'd.)

In short, the evidence presented in this Box, based on data at end-April, indicates that the State guarantee facility is contributing significantly to covering the liquidity needs of the companies hardest hit by the pandemic and that face the greatest difficulties in terms of access to credit. Further, the terms and conditions associated with these credit transactions, in terms of interest rates and in particular loan amounts and maturities, are more favourable than would be applied in the programme's absence. The lengthy average term to maturity of lending under the ICO programme (more than four years) will help to extend the average life of the firms' debt, which will mitigate potential short-term rollover risk. Meanwhile, those companies less affected by the pandemic and with better access to credit have been able to increase their bank finance without resorting to the ICO facility.